



PB 11-13  
May 20, 2011

## WASHINGTON FARES POORLY IN NEW BUSINESS TAX RANKINGS

### BRIEFLY

According to calculations by Ernst & Young LLP, the state and local tax burden faced by businesses siting new facilities or expanding existing facilities in Washington ranks among the highest in the nation.

The Council on State Taxation recently released a study comparing the state and local tax burden on new investment across the 50 states. According to this study, which was prepared by Ernst & Young LLP (E&Y), the average effective state and local tax rate on business investment in new or expanded facilities in Washington ranks among the highest in the nation (E&Y 2011).

E&Y calculates taxes paid by hypothetical businesses in the new study. This approach complements E&Y's annual study that estimates the total state and local taxes paid by business by state. These studies have consistently shown Washington to be a high business tax state (E&Y 2010, WRC 2010).

### Details of the Calculations

In the new study, E&Y models five specific types of operations: a headquarters facility, a research and development facility, an office and call center facility, a durable manufacturing facility, and a non-durable manufacturing facility. For each type of facility a financial profile was developed based on information from federal income tax returns as summarized in the Internal Revenue Service's Statistics of Income Corporate Source Book for 2006.

Facilities are assumed to be organized as C corporations rather than pass-through entities such as S corporations, partnerships or LLCs.

For each hypothetical facility and each state, E&Y projects revenues and expenses over a thirty-year horizon and calculates rates of return both before and after the payment of state and local taxes. The effective state and local tax rate (ETR) is the percentage reduction in rate of return on the capital invested in the facility due to the state and local tax payments. To illustrate: "if state and local taxes reduce the before-tax rate of return [on a facility in a state] from 15 percent to 13 percent, the effective tax rate [on the facility] is 13.3 percent (a two percentage point decrease divided by the 15 percent pre-tax rate of return)" (E&Y 2011, p. 5).

State and local taxes captured in the analysis include corporate income taxes, corporate franchise taxes, sales and use taxes on business purchases (not sales taxes on business sales), and gross receipts taxes (such as Washington's business and occupations tax).

For each state, E&Y reports two weighted averages of the effective tax rates for the five hypothetical facilities. Weights are either the relative share of new capital invested in the type of facility, or the relative share of new jobs created in the type of facility, derived from an E&Y national inventory of new or expanded facilities announced between December 2007 and September 2009.

When the average is calculated using capital investment weights, Maine ranks best among the states, with an average ETR of 3.0 percent, and New Mexico ranks worst, with an average ETR of 16.6 percent. Across the states, the median ETR is 7.3 percent. Washington's average ETR is 9.4 percent, ranking 40<sup>th</sup>.

Effective Tax Rates on New Investment,  
Average of Selected Industries



Ernst & Young/Council on State Taxation  
State and Local Business Tax Competitiveness Index:  
Effective Tax Rate on New Investment  
Average of Selected Industries

	Weighted by:			
	Capital Investment		Jobs	
	ETR	Rank	ETR	Rank
Maine	3.0%	1	4.3%	1
Oregon	3.8%	2	4.4%	2
Ohio	4.4%	3	5.6%	3
Wisconsin	4.5%	4	5.7%	4
Illinois	4.6%	5	6.0%	8
Virginia	5.4%	6	6.6%	10
New Hampshire	5.4%	7	5.9%	6
Delaware	5.7%	8	5.8%	5
Wyoming	5.8%	9	6.4%	9
Minnesota	6.0%	10	7.5%	13
Montana	6.1%	11	6.0%	7
Maryland	6.3%	12	8.7%	25
South Dakota	6.4%	13	7.1%	11
Iowa	6.4%	14	8.1%	18
Kentucky	6.5%	15	7.8%	15
Georgia	6.6%	16	7.9%	16
Utah	6.7%	17	8.0%	17
Colorado	6.8%	18	7.7%	14
Indiana	6.8%	19	8.3%	21
Texas	6.9%	20	8.2%	19
Pennsylvania	7.1%	21	8.3%	20
Missouri	7.1%	22	8.4%	24
New York	7.1%	23	8.9%	27
Michigan	7.2%	24	8.4%	22
Alaska	7.2%	25	7.2%	12
North Dakota	7.3%	26	8.4%	23
Florida	7.4%	27	8.7%	26
New Jersey	7.5%	28	9.2%	31
California	7.7%	29	10.0%	35
Idaho	7.7%	30	9.1%	30
Vermont	7.8%	31	9.0%	29
Massachusetts	8.2%	32	9.7%	34
Nevada	8.2%	33	8.9%	28
North Carolina	8.6%	34	10.2%	36
Oklahoma	8.8%	35	10.5%	38
Arkansas	8.9%	36	10.5%	39
South Carolina	8.9%	37	9.5%	33
Connecticut	8.9%	38	9.4%	32
Arizona	9.3%	39	11.0%	42
<b>Washington</b>	<b>9.4%</b>	<b>40</b>	<b>12.4%</b>	<b>47</b>
Nebraska	9.4%	41	10.2%	37
West Virginia	9.7%	42	10.9%	41
Alabama	9.7%	43	11.0%	44
Mississippi	10.2%	44	10.8%	40
Tennessee	10.3%	45	11.8%	45
Hawaii	10.8%	46	11.0%	43
Louisiana	11.1%	47	12.0%	46
Kansas	11.2%	48	12.5%	48
Rhode Island	11.5%	49	13.4%	49
New Mexico	16.6%	50	17.9%	50
50-State Mean	7.7%		8.9%	
50-State Median	7.3%		8.7%	

When the average is calculated using jobs as weights, Washington's ranking falls to 47<sup>th</sup>, with an ETR of 12.4 percent. Maine and New Mexico again rank best and worst, with average ETRs of 4.3 percent and 17.9 percent respectively, while the median is 8.7 percent.

E&Y draws this general conclusion:

[The study clearly shows] that legislators need to examine the entire system of state and local business taxes, not just a single tax, in evaluating their state's tax competitiveness. In fact, the results suggest that legislators have not paid enough attention to the role of "sales" in understanding tax burdens imposed on business investments and on-going operations. This includes both (1) sales to businesses subject to sales taxes imposed on taxable products and (2) services purchased as business inputs, and the "sourcing" or geographic assignment of sales by business in determining instate corporate income and gross receipts tax bases. Because both sales taxes and entity-level business taxes are levied at high rates, variations in the definition of these tax bases have a significant impact on the competitiveness rankings presented in this study (E&Y 2011, p. 4).

Washington's relatively high tax burden on new investment flows from the high sales tax rate collected on business purchases of goods and services used in the production process and from the B&O tax, which unlike the corporate income taxes imposed in many other states, does not provide a break for out-of-state sales by manufacturers.

## References

- Ernst & Young LLP (E&Y). 2010. Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2009. Prepared in Conjunction with the Council on State Taxation. March.  
<http://www.cost.org/WorkArea/DownloadAsset.aspx?id=76116>
- . 2011. Competitiveness of State and Local Business Taxes on New Investment: Ranking States by Tax Burden on New Investment. Prepared in Conjunction with the Council on State Taxation. April.  
<http://www.cost.org/WorkArea/DownloadAsset.aspx?id=78442>
- Washington Research Council (WRC). 2010. Washington's Business Tax Burden. PB 10-15. August.  
<http://www.researchcouncil.org/docs/PDF/WRCTaxes/CostBriefFinal.pdf>